IBOR reform and Corporate Treasury including Canadian perspective

Two years from now, by the end of 2021 IBOR reference rates will have ceased to exist. By then, financial markets, financial institutions and private companies across the globe will have to have switched to alternative reference rates for pricing transactions and mark to market valuations including outstanding transactions.

At first glance the actions required to migrate might look simple and straightforward; until one grasps how deeply embedded IBOR is in financial processes across the globe and how different migration paths can be. Regulators across the globe are concerned about the transition within their markets only, they are not sensitive to the issues of individual organizations operating in multiple markets. Consequently - and given the different alternatives to IBOR and migration timelines - IBOR transition should not be underestimated.

This paper discusses some of the more practical issues all organizations, including Canadian corporations face. It also includes a checklist for your IBOR reform project. To the extent you have not yet such a plan, I would urge you to put it in place rather sooner than later.

Anytime before 31 December 2021 IBORs may become less reliable, if not non-viable, reference rates which may coerce organizations to migrate at a moment not of their own choice.

1) CDOR will continue after 2021, but will it be backed by sufficient liquidity?

Unlike many of its peers, CDOR, the Canadian IBOR, will continue to exist after 2021. This sounds like good news for planning migrations. However, it remains to be seen to what extent CDOR and its proposed successor CORRA, will be backed by a sufficiently liquid market for both to be a viable standard and play the role of a reference rate credibly. It would be entirely possible that only one of them will survive and which one is not clear as of yet.

2) Migration might be earlier then 31 December 2021

Although the end date for IBOR reference rates outside Canada is set to be 31 December 2021, individual IBOR reference rates may cease to be viable references well before that date. Key market players will migrate to the alternative reference rates well before 31 December 2021. This will drain liquidity from the underlying markets and may trigger other parties to switch off that IBOR reference rate. Anytime before 31 December 2021 IBORs may become less reliable - if not non-viable - reference rates and coerce organizations to migrate at a moment not of their own choice.

The risk to consider is that to the extent that the underlying markets become illiquid, IBOR rates may cause pricing anomalies and ineffectiveness in existing hedge relationships.

3) Migration might be different by market and counterparty

The tipping point for an IBOR being no longer viable might be different by market and individual participants might perceive the moment differently. The consequence of this logic is that parties that are dependent on multiple IBOR reference rates and different counterparties for funding and hedging, better plan for a phased migration away from IBOR in the next 24 months. In this respect migration of cross currency swaps pose a special challenge as their legs are referencing different markets. Therefore, planning should be flexible enough that it can accommodate sudden changes given market conditions.

4) Alternative reference rates are different in nature

The alternative reference rates proposed are often backward-looking, overnight rates. Some of these new reference rates are based on collateralized instruments, others are based on unsecured instruments. Because IBOR is forward-looking based on unsecured instruments this has several practical implications.

Firstly the margin added to the base rate will be adjusted at change over to reflect the discrepancy in the definition of the base rate. Consequently at change over date, outstanding transactions in deal registration and valuation systems such as the TMS will have to be updated not only to reference a different base rate, but also a different spread.

Existing IBOR reference rate	**Proposed alternative reference rate**	**Borrowing type**	**Regulatory Framework group**
CAD CDOR	CORRA Enhanced Canadian Overnight Repo Reference Average	Secured	BoC / CARR
USD LIBOR	SOFR Secured Overnight Financing Rate	Secured	Alternative Reference Rates Committee
EUR LIBOR	€STR Euro Short-Term Rate	Unsecured	European Working Group
GBP LIBOR	SONIA Reformed Sterling OverNight Index Average	Unsecured	BoE's working group on Sterling Risk Free Rates
CHF LIBOR	SARON Swiss Average Rate OverNight	Secured	National Working Group onSwiss Franc Reference Rates
JPY LIBOR	TONAR Tokyo OverNight Average Rate	Unsecured	Japanese study group on reference rates

Perhaps even more consequential is the fact that many of the new reference rates are no longer forward looking. This implies that the interest for the current interest period is based on the average of the daily rates in the period itself. This implies that the interest amount is not known until 2 days before settlement and interest calculations, valuation and back office processes in your TMS will need to be reviewed and updated.

Call to action

IBOR reform calls for action in the next 24 months. With regards to what and when to act much is still shrouded in uncertainty. Having said that, corporate treasurers can prepare themselves and their organization already for when it is time to act. Furthermore, all preparations now will alleviate the work to be done later.

- Stay informed
- Scope the IBOR reform project:
- To the extent not completed yet, treasurers should take stock of all contracts and processes that refer to IBOR reference rates. This should drive a communication plan with all internal and external stakeholders with regards to actions to be considered, dependencies and possible timing of execution.
- Review legal contracts expiring after transition and referring to IBOR reference rates
- This action point does not see to only loan documentation and ISDAs. IBOR references could also be in operational lease contracts, rental agreements and core business contracts with vendors and customers. Organizations may want to ensure that e.g. contract language accepts transitions proposed and endorsed by regulators as well as fall back clauses that are meeting your requirements.

Make sure your systems are ready when needed

System readiness is a project in and of itself. Treasurers will need to understand what and how changes must be made to individual transactions at cut-over. This include a.o. retrieving new market data points, configuration of yield curves, updating individual transactions (base rate, margin), interest settlement and (hedge) accounting processes. Treasurers also must make sure that these changes will not have unintentional consequences for accounting and reporting going forward. This reference to systems is not only to an in-house TMS, but also to vendor supported software, SaaS, as well as any (in-house) spreadsheet-based processes. Will all these applications support your treasury processes properly?

Furthermore, and to the extent that the vendor applications support the IBOR reform implications, treasurers will need to make sure that the version of the application available to them, supports their IBOR reform requirements. To the extent that organizations operate on a lower version of a software solution, treasurers should plan upgrade or migrate away from the software ahead of time.